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The risks and the governments

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Abstract

While risks are increasingly globalized and interconnected, global governance capacities are highly fragmented, and for that, the aim of this article is to point out to the role and the responsibility of the governments on some risks; the government's priorities and strategy in combating these risks; the policy and legislative actions of any government, at national, state, and local levels, that have significant impacts on the management and control of risk. The purpose of this paper is to provide a framework for analysing the role of governments in helping people and businesses adapt to all this risks. The most important directions where the governments have the power to impede the risk's consequences are: environmental risks, geopolitical risks and the risk in the financial market.

Keywords: risks, environmental risks, geopolitical risks;Introduction

1. Introduction

The desire of many people is a risk-free society and the public points out to the government that it's their responsibility. The major risks in society at this moment are, in our opinion, climate change, the increasing shortage of raw materials, regional conflicts, wars and terrorist threats, corruption and obviously the economic crisis (http://www.primo-europe.eu/2009/10/an-interview-with-peter-van-zunderd-head-of-the-safety-region-mid-and-west-brabant-about-risks-and-government%E2%80%99s-responsibility-the-major-risks-in-society-and-how-to-deal-with-them/). Governments also need to keep an eye on the potential so as public finances should not become a risk to the overall economy and the financial system, according to Jaime Caruana, head of the Bank for International Settlements (which serves as a bank for central banks around the world) (http://www.imf.org/external/pubs/ft/survey/so/2011/pol041911a.htm).

Proposals for the future role of government in the financial markets depend critically on the lessons learned about the role of government under the current financial crisis (http://media.hoover.org/sites/default/files/documents/Systemic%20Risk%20and%20the%20Role%20of%20Government-May%2012%202009.pdf).

2. Environmental risks

Sustainability and climate issues are a high priority for many governments, yet the temptation to delay policy responses is becoming stronger as energy prices soar and governments seek to reduce spending

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(http://www.ey.com/Publication/vwLUAssets/Turn_risk_and_opportunities_into_results:_government_and_public_sector/$FILE/Business%20Challenge%20GPS%20report-SCORED.pdf).

People and organizations who wish to adapt to the effects of the changing climate may encounter a number of barriers, for example:

- lack of information or awareness of climate impacts
- complexity of decisions required due to the long-time horizons and uncertainties over how exactly the climate will change
- financial constraints.

The government can play a role in supporting people and businesses to overcome some of these barriers and create an environment conducive to the appropriate adaptation decisions. Adaptation decisions are not made in a vacuum – the options and incentives available are shaped by a range of non-climate related policies and institutional arrangements. This framework for thinking about the costs and benefits of adaptation, and the barriers to adaptation can help to provide policy design. Interventions to overcome barriers to adaptation can be assessed against three criteria:

- Effectiveness – the policy should reduce vulnerability to climate change;
- Efficiency – the benefits should outweigh the costs; and
- Equity – distributional consequences should be taken into account.

Given the long-term nature of climate change and inherent uncertainty, it is vital that policies are designed with the flexibility to respond to changing circumstances and better information (Michael Mullan, 2010).

There is a clear need to improve our understanding of the long-term fiscal implications of climate change; the built environment will need to be adapted in order to reduce the risks associated with rising temperatures and more frequent extreme events; the natural environment will adapt, but the rapid pace of climate change risks disruption and losses of biodiversity and ecosystem services.

The governments may take action either to achieve a more efficient outcome than would otherwise occur, or on distributional grounds, as is the standard approach to policy making (HM Treasury, 2003). This also means that in designing and implementing policies, programmes and investments, the Government should account for the impacts of climate change. In some cases, private incentives to adapt should be a sufficient trigger for changing behaviour, and when the market operates efficiently the price mechanism should lead to the most efficient adaptation outcome.

Climate change will also have macroeconomic impacts, e.g. by affecting productivity, growth, migration and potentially the fiscal position of governments.

The policy response to adaptation should be driven by the characteristics of the climate risks to be addressed. One of the main aspects of this is that the appropriate adaptive response will vary depending on the location, as many of the benefits will occur locally. This favours a decentralised approach based on an efficient allocation of resources, with a strong emphasis on supporting local and regional action. The Government can help to create an environment that is conducive to effective, efficient and equitable adaptation by:

- providing and promoting information on the future climate;
- supporting coordination at local and regional levels;
- devising a framework that embeds consistent policy targets and incentives across different levels of government, while promoting coordination; and
- directly providing or funding adaptation.

The aim is to provide decision makers with the appropriate incentives to incorporate adaptation into their strategies and processes.

One of the most important global governance failures is the weak or inadequate global institutions, agreements or networks, combined with competing national and political interests, impede attempts to cooperate on addressing global risks. While risks are increasingly globalized and interconnected, global governance capacities are highly fragmented (World Economic Forum in collaboration with: Marsh & McLennan Companies Swiss Reinsurance Company Wharton Center for Risk Management, Zurich Financial Services – Global Risks – 2011 Sixth Edition, An initiative of the Risk , 2011). The governments must take clear and firm actions to ensure its processes and organizations are adapting to climate change. Also, the adaptation is an issue across the European Union, so that, in April 2009 the European Commission presented a policy paper known as a White Paper. This presented the framework for adaptation measures and policies to reduce the European Union vulnerability to the impacts of climate change (http://www.defra.gov.uk/environment/climate/government/).

3. Geopolitical risks

When considering the wider environment of risk handling in modern societies, many classes of influential factors come into play. Only a few can be mentioned here. For example, the distinction between horizontal and vertical governance can be helpful in describing and analysing cases of risk handling in different countries and contexts. In addition, the interplay between economic, political, scientific and civil society actors needs to be addressed just looking beyond governmental or corporate actions (Renn, 2005).

Illicit trade, organized crime and corruption are chronic risks that are perceived as highly likely to occur and of medium impact. As a highly interconnected nexus representing the illegal economy, however, experts see these risks as of central importance to the global risk landscape. Both data and experts suggest that the nexus heavily influences three other important global risks – fragile states, terrorism and geopolitical conflicts – which, in turn, have a significant and negative impact on global stability. The impacts of this nexus of risks can also spread far beyond emerging economies. For example, illicit trade of intellectual property-protected goods reduces incentives for innovation and investment. Trade in counterfeit medicines risks human health globally.

Security risks arising from fragile states – terrorism and geopolitical conflict – may have broad consequences. While the insurance industry, government and modellers try to manage also the risks of terrorism, they face a number of challenges -- including continuing terrorist attacks abroad.

Table 1. Impact of risks related to the illegal economy nexus (non-exhaustive)

Impacts	Direct Impacts	Indirect Impacts
Impact on governments	•Weakened institutions/undermining and corruption of the rule of law • Erosion of civil service function/capture of state institutions by corruption • Lack of continuity in policies affecting business •Small tax base/loss of revenue • Exodus of capital •Threats to political stability	•Decreased regional investments •Shift of power to disruptive groups
Impact on society / populations	• Erosion of trust in public institutions •Potential for draconian responses that limit economic opportunity (stricter migration policies) • Brain drain / skill depletion from emigration	•Reduction in tourism •Destruction of biosphere through unregulated activities • Criminalization/marginalization of segments of the population
Impact on business	•Increased transaction costs •Lost legitimate sales •Deterred / appropriated investments •Exposure to threats, bribes and reduced security of personnel	•Higher costs of capital •Pressure to participate in corrupt practices through perceived competitive disadvantage

Source: World Economic Forum

The table shows, corruption in both emerging and advanced economies is a low-intensity transaction cost that stifles growth, distorts markets and undermines the rule of law (World Economic Forum in collaboration with: Marsh & McLennan Companies Swiss Reinsurance Company Wharton Center for Risk Management, Zurich Financial Services – Global Risks – 2011 Sixth Edition, An initiative of the Risk , 2011).

Similarly, while global governance failures have created a growing space for illegal activities, these activities have, in turn, tended to undermine efficient global governance.

4. Government and the market in the financial crisis

The economic analysis of government policy usually starts with the presumption that it is better for government not to intervene if a problem can be otherwise resolved. In some cases, when a free market outcome is considered unsatisfactory, it may be possible to improve the situation with the use of taxes or subsidies, which aim to discourage or encourage particular activities by altering market prices. It may also be possible to improve market outcomes simply by providing relevant information to the public, to enable more informed choices to be made. In other cases, government may judge that such measures alone would not be sufficient to generate the desired change in behaviour and that other, more direct, forms of intervention are needed to regulate or proscribe behaviour (Government Policy on the Management of Risk, 2005).

Proposals for the future role of government in the financial markets depend critically on the lessons learned about the role of government in the current financial crisis. To answer the question about the role of government and systemic risk, it is important therefore to examine carefully whether government or the market was the systemic factor in this crisis. By definition a systemic risk in the financial sector is a risk that impacts the entire financial system and real economy, through cascading, contagion, and chain-reaction effects. The triggering event for such a macro impact can come from the public sector— when the central bank suddenly contracts liquidity, or from the financial markets— when a large private firm fails, or externally— when a natural disaster or terrorist attack shuts down the payments system.

Examples of systemic events prior to the current crisis were the default by the Russian government in 1998 which affected markets around the world leading the Federal Reserve to cut interest rates, and the 9/11 terrorist attacks which spread through the payments system in the United States by severely damaging financial firms intimately engaged in the system. It is important to emphasize that contagion or chain reactions are not automatic; they can be altered by changes in the rules of the game established by public policy. When Argentina defaulted on its debt in 2001, three years after the Russian default, there was no global contagion, even though the world economy was in worse shape, primarily because the rules of International Monetary Fund (IMF) support were better explained and anticipated (http://media.hoover.org/sites/default/files/documents/Systemic%20Risk%20and%20the%20Role%20of%20Government-May%2012%202009.pdf).

Government must develop a sound and potentially useful framework for the assessment of risk. The key issue is whether this framework will be applied properly. Cost-benefit analysis provides a useful framework for thinking about risk policy, but costs and benefits are often uncertain or difficult to measure and it is important to recognise the limitations of quantitative approaches to risk assessment.

The governments should invest in or provide loans to financial firms whose devaluation of risk helped create today's credit crisis. The government must encourage the investments, but, behind the recent decline of inward investment there are many factors. In many developing countries, privatization activities have come under increased scrutiny, and efforts to improve the investment climate have slowed down. Not only have many emerging market governments paused to reassess the costs and benefits of private investment, but also there is a heightened perception of risk in virtually every sector and region. Faced with crises in the Middle East, political and economic turmoil in parts of South America, and continued terrorist threats in every region, there seems to be no realistic prospect for sustained investor attention to emerging markets on the immediate horizon (Moran, 2004).

Maybe a solution is that the government must subsidizing risks, like American's government did. Explicit subsidizations of risk are those in which the government has made an official declaration about backing an organization or program with U.S. Treasury funds. While the economic theory of the government subsidization of risk is fascinating, most people are ultimately concerned with practical advantages and disadvantages of the government absorbing some of the risk from various economic markets.

There's no doubt that the biggest benefit to most consumers is easier and less costly access to borrowed funds. While that may make a sufficient case for many when it comes to the government subsidization of risk, it does come with a large practical disadvantage - the on-going cost to taxpayers. Government subsidization is not free, and the costs will ultimately need to be absorbed somewhere. Of course, when government finances are already stretched to the breaking point, this means that it gets passed on to future taxpayers by adding to the national debt. In a worst-case scenario, with the government stepping up to meet multiple implied obligations at once, a crushing obligation could get transferred to future generations (http://www.investopedia.com/articles/financial-theory/09/government-subsidizing-risk.asp#axzz1bbPqQe9y).

5. Conclusion

Understanding the level of risk (including opportunities as well as threats) posed by climate changes, and comparing the risks posed by a changing climate with other pressures on the government, prioritise adaptation policy. In many cases the role of Government will be limited. The private benefits from adapting, for example in terms of avoided losses, or economic revenues when new opportunities are exploited, will be a sufficient incentive for many people to adapt. However, recurring cases of disruption to transport services, damage to private assets, and the risk of irreversible damage to ecosystems raise the question of whether we are adequately adapted to the current climate, and make a strong case for investigating what barriers may hinder adapting to the current and future climate (Michael Mullan, 2010).

The global financial system allows the profits of illicit trade, organized crime and corruption to be transferred and hidden. This protects participants, deprives governments of tax revenue and shifts tax burdens from capital onto wages and consumption. Ensuring transparency of financial flows would reduce opportunities for money to be laundered or transferred out of emerging economies, as well as enabling more effective law enforcement (World Economic Forum in collaboration with: Marsh & McLennan Companies Swiss Reinsurance Company Wharton Center for Risk Management, Zurich Financial Services – Global Risks – 2011 Sixth Edition, An initiative of the Risk , 2011).

Risk management policies should be targeted at specific market failures and well-defined equity concerns. Some risk management markets are incomplete and therefore not all risks can be insured, pooled or transferred through market instruments. This is not a proof of market failure, and the appropriate role of government depends on the whole risk management system (http://www.oecd.org/document/14/0,3746,en_21571361_43893445_44355854_1_1_1_1,00.html.).

The principles of risk management by the UK's government are:

• openness and transparency - Government will be open and transparent about its understanding of the nature of risks to the public and about the process it is following in handling them

• involvement - Government will seek wide involvement of those concerned in the decision process

• proportionality and consistency - Government will act proportionately and consistently in dealing with risks to the public

• evidence - Government will seek to base decisions on all relevant evidence

• responsibility - Government will seek to allocate responsibility for managing risks to those best placed to control them (Government Policy on the Management of Risk, 2005).

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